

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B03

PLR-118156-07

Date:

January 23, 2008

Legend:

Company =

Decedent =

Trust =

Beneficiary =

Shareholders =

=

=

State =

D1 =

D2 =

D3 =

D4 =

D5 =

Dear :

This letter responds to a letter dated April 10, 2007, and subsequent correspondence, submitted on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code.

Facts

Company was incorporated under the laws of State on D1, and elected to be an S corporation under § 1362(a), effective D1.

On D2, Decedent created Trust, a grantor trust, and transferred Decedent's shares of Company stock to Trust. As of D2, the shareholders of Company were Shareholders and Trust.

On D3, Decedent died and Trust became an irrevocable trust that continued to hold the shares of Company stock. Upon Decedent's death, Trust ceased to qualify as a grantor trust. Trust continued to qualify as a permitted subchapter S trust under § 1361(c)(2)(A)(ii) for the two-year period beginning on the date of the deemed owner's death. From D3 and thereafter, Beneficiary is the sole income beneficiary of Trust. It is represented that the terms of Trust possess all the elements of a qualified subchapter S trust (QSST), as defined in § 1361(d)(3) and the regulations thereunder.

On D4, Company's tax preparer discovered that the QSST election for Trust was never filed. Company, Shareholders, Beneficiary, and Trust were not aware of the failure to file a QSST election. It is represented that at all times since Decedent's death, Company, Shareholders, Beneficiary, and Trust intended that Trust be a permitted S corporation shareholder.

Company represents that it did not intend to terminate its S corporation election, and that the termination was inadvertent and not motivated by tax avoidance or retroactive tax planning. Company further represents that at all times since D1, Company and its shareholders have treated Company as an S corporation. Company and its shareholders agree to make any adjustments, consistent with the treatment of Company as an S corporation, as may be required by the Secretary.

Company requests a ruling for relief from the inadvertent termination of its S corporation election under § 1362(f).

Law

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any tax year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder of an S corporation.

Section 1361(c)(2)(A)(ii) provides that for purposes of § 1361(b)(1)(B), a trust which was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after the death, is a permitted shareholder, but only for the 2-year period beginning on the day of the deemed owner's death.

Section 1361(d)(1) provides, in part, that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2), the trust shall be treated as a trust described in § 1361(c)(2)(A)(i), and for purposes of § 678(a), the beneficiary of the trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply.

Section 1361(d)(3) provides that for the purposes of § 1361(d), the term "qualified subchapter S trust" means a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only 1 income beneficiary of the trust, (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to the beneficiary, (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of the beneficiary's death or the termination of the trust, and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary, and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of the QSST must make the election under § 1361(d)(2) by signing

and filing with the service center with which the corporation files its income tax return the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a), § 1361(b)(3)(B)(ii), or § 1361(c)(1)(A)(ii) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under paragraph (2) or (3) of § 1362(d), § 1361(b)(3)(C), or § 1361(c)(1)(D)(iii), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken (A) so that the corporation for which the election was made or the termination occurred is a small business corporation or a qualified subchapter S subsidiary, as the case may be, or (B) to acquire the required shareholder consents, and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation or a qualified subchapter S subsidiary, as the case may be) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation or a qualified subchapter S subsidiary, as the case may be, during the period specified by the Secretary.

Section 1.1362-4(b) provides that for purposes of § 1.1362-4(a), the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event, tends to establish that the termination was inadvertent.

Conclusion

Based solely on the facts submitted and the representations made, we conclude that Company's S corporation election terminated on D5, when the two-year period beginning on the date of Decedent's death ended, and Trust became an ineligible shareholder. We further conclude that this termination was inadvertent within the meaning of § 1362(f). Thus, under the provisions of § 1362(f), Company will be treated as an S corporation from D5, and thereafter, provided that Company's S corporation election is valid and is not otherwise terminated under § 1362(d).

As conditions for this ruling, (1) Trust must file a QSST election with an effective date of D5 within 60 days of the date of this letter (a copy of this letter must be attached to the election); and (2) each Shareholder and Trust, in determining their federal tax liability during the termination period, must include their pro rata share of the separately and nonseparately computed items of Company under § 1366, make any adjustments to stock basis under § 1367, and take into account any distributions made by Company to its shareholders as provided in § 1368.

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provisions of the Code. Specifically, we express or imply no opinion concerning whether Company is otherwise qualified to be an S corporation or whether Trust is otherwise qualified to be a QSST.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to the taxpayer's authorized representative.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

/s/

Leslie H. Finlow
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for section 6110 purposes

cc: